

# CRS Report for Congress

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## Argentina: Political and Economic Conditions and U.S. Relations

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### Summary

Argentina's restructuring of over \$100 billion in defaulted bond debt in June 2005 demonstrated the country's emergence from its 2001-2002 economic crisis that had caused severe stress on the political system. Current President Néstor Kirchner, elected in 2003, has made bold policy moves in the areas of human rights, institutional reform, and economic policy that have helped restore Argentines' faith in democracy. The October 2005 legislative elections demonstrated strong support for President Kirchner, whose popularity at this juncture bodes well for his re-election if he chooses to run in the October 2007 presidential election. Economic growth has rebounded since 2003, and in January 2006, Argentina paid off its \$9.5 billion debt to the International Monetary Fund. Looking ahead, the government faces such challenges as reducing poverty and controlling inflation while maintaining strong economic growth. Issues of concern to Congress include continued cooperation with Argentina on counter-terrorism issues and progress in Argentina's investigation of the 1994 Argentine-Israeli Mutual Association bombing. For additional information, see CRS Report RL32637, *Argentina's Sovereign Debt Restructuring*, and CRS Report RL33620, *Mercosur: Evolution and Implications for U.S. Trade Policy*, by J. F. Hornbeck.

### Political and Economic Background

Argentina's political upheaval in late 2001 that led to the resignation of President Fernando de la Rúa should be viewed in the context of its historical political development. Before 1930, Argentina enjoyed some 70 years of political stability that facilitated rapid economic development and made Argentina one of the world's wealthiest countries. It ranked seventh in the world in per capita income in the 1920s.<sup>1</sup> In contrast, from 1930 until 1983, Argentina experienced significant political instability, characterized

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<sup>1</sup> Thomas G. Sanders, "Argentina and the Politics of Economic Distress," UFSI Field Staff Reports, 1988-89, No. 4, p. 1.

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by numerous military coups, 25 presidents, 22 years of military rule, and 13 years of “Peronism.”<sup>2</sup>

When the military intervened in 1943, the regime came to be dominated by a colonel serving as Secretary of Labor, Juan Peron, who went on to build a formidable political base through support from the rapidly growing union movement. Peron’s mobilization of the working class had an enduring effect on Argentina’s political system over the next four decades. Even when Peron was ousted by the military in 1955, Peronism as a political movement survived despite attempts by the military and anti-Peronist sectors to defeat it. After his ouster, a series of civilian and military governments ruled until 1973 when Peron was reelected to office after 18 years of exile. Just a year later, however, Peron died and was succeeded by his second wife Isabel, who had little political experience. Economic and political chaos ensued, with political violence surging and Argentina experiencing its first bout of hyperinflation. As a result, the military intervened once again in 1976, but this time ruled directly until 1983, when it fell into disrepute in the aftermath of its failure in the Falkland Islands (Islas Malvinas) war with Great Britain in 1982. It was during this period that the military conducted the so-called “Dirty War” against leftists, guerrillas, and their sympathizers, and thousands of Argentines “disappeared.”

In 1983, Argentina returned to civilian democratic rule with the election of Raul Alfonsin of the moderate Radical Civic Union (UCR). Alfonsin was widely credited with restoring democratic institutions, but economic conditions during his tenure were chaotic, with hyperinflation and considerable labor unrest. As a result, Alfonsin left office six months before his six-year term ended, letting the winner of the 1989 election, Carlos Menem of the Justicialist Party (PJ, or the Peronist Party), take office early.

Menem transformed Argentina from a state-dominated protectionist economy to one committed to free market principles and open to trade. Most state enterprises were privatized; hyperinflation was eliminated; and the economy was opened up to foreign trade and investment. In 1991, under the direction of Minister of Economy Domingo Cavallo, the government pegged the Argentine peso to the U.S. dollar and limited the printing of pesos to the extent that they were backed by U.S. dollars, a policy which helped keep inflation in check, but as is now known, became a major factor in Argentina’s recent financial turmoil. (The dollar peg led to an overvaluation of the peso, and continued overspending led to large increases in external debt.) What made Menem’s transformation of Argentina even more extraordinary was that he broke with the traditional Peronist protectionist policies favorable to the working-class and labor. Yet increasing corruption and high unemployment at the end of Menem’s second term were factors that led to the defeat of his party in the October 1999 elections.

**From De la Rúa to Duhalde.** Fernando de la Rúa won the October 1999 presidential race as the candidate of a coalition known as the Alliance for Work, Justice, and Education, that brought together de la Rúa’s moderate Radical Civic Union (UCR) and the leftist Front for a Country in Solidarity (Frepasó). Although there was initial

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<sup>2</sup> Carlos Waisman H. “Argentina: Autarkic Industrialization and Illegitimacy,” in *Democracy in Developing Countries, Volume Four: Latin America*, edited by Larry Diamond, Juan L. Linz, and Seymour Martin Lipset, Boulder, Colorado: Lynne Rienner Publishers, 1989, p. 63.

optimism when de la Rúa took office in December 1999, that optimism had faded by the end of 2000 because of doubts about the government's ability to bring about economic recovery and because of corruption in the administration. While the government negotiated several financial arrangements with the IMF in 2000 and 2001, it was unable to fulfill IMF-imposed conditions relating to spending cuts. The IMF ultimately declined further financial support in December 2001, because Argentina could not produce a balanced budget. Argentines began rapidly withdrawing dollars from banks until the government limited withdrawals to \$1,000 per month. The denial of access to bank funds, combined with already high poverty and unemployment rates after four years of recession, sparked widespread opposition to the government.

As confidence in the government evaporated, widespread demonstrations erupted around the country, with thousands calling for the President's resignation. Protests turned violent with rioters battling police with stones and bottles; 27 people were killed in the protests and hundreds were injured. Some blamed riot police for overreacting to peaceful demonstrations. As a result of the violent protests, President de la Rúa fled the presidential palace and resigned on December 20, 2001, paving the way for a series of interim presidents from the Peronist party. Peronist Senator Eduardo Duhalde ultimately became president on January 1, 2002, with a mandate from Congress to serve out the remainder of de la Rúa's term. Duhalde, who had been Vice President under Menem from 1989-1991, Governor of the Buenos Aires province, and the PJ's 1999 presidential candidate, was one of the most well-known and powerful Peronist leaders.

President Duhalde faced daunting political and economic challenges when he assumed office, most significantly the ability to quell social unrest associated with the country's financial instability. Protests against banks and politicians continued in the first half of 2002, but the widespread social violence of December 2001 was not repeated, and the Duhalde government survived. Duhalde initially promised such populist measures as increasing the state's role in the economy and protecting local industries, but he did not pursue a protectionist economic model. In the end, the Argentine economy stabilized under the Duhalde government. As part of his economic plan, Duhalde abandoned the Argentine currency's one-to-one peg to the U.S. dollar that had been in place since 1991 and ultimately adopted a unified floating exchange rate in February 2002. While the Duhalde government was unable to secure IMF financing in 2002 because of lack of progress on key fiscal and other structural reforms, it did secure a seven-month IMF arrangement in January 2003, valued at almost \$3 billion. The Duhalde government was also able to clear Argentina's arrears with the World Bank and the Inter-American Development Bank, which allowed new loans in early 2003 to finance social safety net programs in order to reduce the impact of the economic crisis on the poor.

## Challenges for the Kirchner Government

**Kirchner's Election.** Provincial governor Néstor Kirchner, a center-left Peronist, was inaugurated to a four-year term as president on May 25, 2003. Kirchner had emerged from the crowded 19-candidate first presidential election round held April 27 with 22% of the vote. Former President Carlos Menem, a center-right Peronist, topped the field with 24.36% of the vote, and the two candidates were scheduled to compete in a second round on May 18. But when it became apparent that Kirchner was forecast to win with nearly 70% of the vote, Menem pulled out of the race. During the campaign, Menem had advocated a neo-liberal free-market strategy to resolve Argentina's economic problems,

including adoption of the U.S. dollar and increased economic linkages with the United States. In contrast, Kirchner advocated a continuation of Duhalde's economic policies and pledged to keep on the current Minister of Economy, Roberto Lavagna, viewed as the man behind the country's recent economic recovery. He attacked Menem's neo-liberal rhetoric and vowed to demand a reduction in debt and interest rates when negotiating with international creditors. Kirchner was viewed as somewhat of a political outsider, not associated with the corruption legacy of the past, and his candidacy attracted independents, an important factor given that traditional politicians had been discredited.

**Progress and Challenges for Kirchner.** President Kirchner's bold policy moves in the areas of human rights, institutional reform, and economic policy have helped restore Argentines' faith in government. He has attacked corruption in the federal police force and in Argentina's Supreme Court, which had been stacked with the supporters of former President Menem.

Upon taking office, President Kirchner purged the military's top officers and vowed to prosecute current and retired military officials responsible for human rights violations conducted during the last era of military rule. At a dedication of a Museum of Memory commemorating the thousands of Argentines killed in the so-called "Dirty War," Kirchner asked "for forgiveness on behalf of the state for the shame of having remained silent about these atrocities during 20 years of democracy."<sup>3</sup> He strongly supported the Supreme Court's June 2005 overturning of two amnesty laws from the 1980s that had blocked prosecution for killings under military rule. The action opened the door for trials of former military and police officials. In August 2006, a former federal police official was sentenced to 25 years in prison in the first trial since the Supreme Court's action, and in September 2006, the former police commissioner of Buenos Aires, Miguel Etchecolatz, was sentenced to life in prison. A key witness in the Etchecolatz case, Jorge Julio Lopez, disappeared after his testimony, provoking widespread concerns about a potential return of death squads intended to intimidate witnesses in future human rights trials. President Kirchner has called for Argentines to stay on alert so that the past is not repeated.<sup>4</sup>

In the economic arena, the Kirchner government has overseen a strong revival of the Argentine economy, with economic growth rates of 8.8% in 2003, 9% in 2004, 9.2% in 2005, and an estimated growth rate of 7.8% in 2006. Unemployment decreased from a high of about 24% in 2002 to about 11% in early 2006. In June 2005, the Kirchner government was successful in restructuring more than \$100 billion in defaulted bond debt at about 34 cents on the dollar, saving the country more than \$67 billion in the largest debt-reduction ever achieved by a developing country. Although Argentina's macroeconomic recovery has been impressive, many poor and middle-class Argentines have yet to see major improvements in living standards. Although poverty rates have declined over the past three years, about 34% of the population was still estimated to be in poverty in 2005, with almost 12% of the population living in extreme poverty. The

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<sup>3</sup> Hector Tobar, "Argentine Ceremonies Cast Light on 'Dirty War'," *Los Angeles Times*, March 25, 2004.

<sup>4</sup> Larry Rohter, "Death Squad Fears Haunt Argentina," *New York Times*, October 8, 2006.

Kirchner government also faces the challenges of curbing inflation, which is forecast to average 11% in 2006, while at the same time maintaining strong economic growth.<sup>5</sup>

Argentina's relations with the IMF under the Kirchner government have been contentious at times. In September 2003, after months of tough negotiations, Argentina reached a three-year stand-by agreement that provided a credit line of about \$12.5 billion. Although IMF accords are not normally politically popular, the accord was widely praised in Argentina as an agreement with realistic fiscal targets that would enable Argentina to deal with such issues as employment and social equity. Argentina suspended its IMF loan program in August 2004 because of IMF pressure on completion of debt negotiations with bondholders and on Argentine progress in implementing key economic reforms. In January 2006, Argentina ultimately chose to repay its \$9.5 million debt owed to the IMF in order to give the government autonomy on economic policy. Although the move was politically popular in Argentina, some critics argue that it would have been wiser to pay down other more expensive debt or to use the money on infrastructure or social spending.

President Kirchner remains widely popular. For many observers, the October 2005 legislative elections served as a referendum on the Kirchner government and demonstrated continued strong support. One-third of the Senate and one-half of the Chamber of Deputies were contested in the elections. Kirchner emerged from the elections with his supporters having a majority of 40 seats in the 72-member Senate and 108 seats in the 257-member Chamber of Deputies, including a number of pro-Kirchner supporters from parties other than the PJ. The contest was significant because it asserted Kirchner's dominance over the Peronist party faction led by former President Duhalde. Most analysts believe that Kirchner would likely win the October 2007 presidential election if he chooses to run.

## **U.S. Relations**

U.S.-Argentine relations have been strong since the country's return to democracy in 1983 and were especially close during the Menem presidency. U.S. officials commend Argentina's contributions to peacekeeping operations worldwide, including a contribution to the current U.N. peacekeeping mission in Haiti. Because of its military contributions, the United States designated Argentina as a major non-NATO ally in 1997, a status that gives Argentina access to grants of surplus military hardware. Although U.S.-Argentine relations are close, at times there have been irritants in the bilateral relationship. The tough U.S. approach toward Argentina during its political and financial crisis in 2001-2002 caused some friction in the relationship. This turned around to some extent in 2003 when the United States supported Argentina in its negotiations with the IMF.

In terms of trade, the United States exported \$4.1 billion in goods to Argentina in 2005 (with machinery, organic chemicals, and electrical machinery exports topping the list) and imported \$4.6 billion in goods, almost half consisting of oil imports. In 2004, the United States Trade Representative (USTR) placed Argentina on the Special 301 Priority Watch list regarding intellectual property rights protection because of serious concerns over the lack of adequate protection for copyrights and patents. Although the country made some improvements to its international property protection, USTR kept

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<sup>5</sup> "Argentina: Country Report," Economist Intelligence Unit, September 2006.

Argentina on the Priority Watch List for 2005 and 2006 because of continued problems with patent protection and copyright piracy.

U.S. officials have highlighted concerns about the tri-border area (TBA) of Argentina, Brazil, and Paraguay because of activities of the radical Lebanon-based Hezbollah (Party of God) and the Sunni Muslim Palestinian group Hamas (Islamic Resistance Movement). The TBA has long been used for arms and drug trafficking, contraband smuggling, document and currency fraud, money laundering, and the manufacture and movement of pirated goods. The State Department's 2005 annual report on terrorism (issued in April 2006) maintains that the United States remains concerned that Hezbollah and Hamas were raising funds among the sizable Muslim communities in the region but stated that there was no corroborated information that these or other Islamic extremist groups had an operational presence in the area. U.S. officials in the past have lauded engagement with Argentina on counter-terrorism issues, including efforts to crack down on Middle East fund-raising activities in the TBA. In September 2006, however, a U.S. Treasury Department official maintained that Argentina could risk international financial isolation if it did not take action to criminalize terrorist financing.<sup>6</sup>

Congress has expressed concern regarding Argentina's investigation into the July 1994 bombing in Buenos Aires of the Argentine-Israeli Mutual Association (AMIA) that killed 85 people. In the 108<sup>th</sup> Congress, both houses approved similar resolutions (H.Con.Res. 469 and S.Con.Res. 126) in July 2004, that urged Argentina to provide resources to investigate all areas of the AMIA case. Allegations have linked Hezbollah to that bombing as well as to a 1992 bombing of the Israeli Embassy in Buenos Aires that killed 30 people. In September 2004, all 22 Argentine defendants charged in the 1994 bombing were acquitted by a three-judge panel that faulted the investigation of the original judge (the judge was ultimately removed from office for bribery in August 2005). Despite the acquittal, an Argentine court reconfirmed the validity of international arrest warrants for 12 Iranian nationals and one Lebanese official believed to head Hezbollah's terrorist wing. (Interpol suspended international wanted notices, or Red Notices, for the 12 Iranians, in October 2004, and cancelled the notices in September 2005, maintaining that new arrest warrants were needed.) A new Argentine investigation of the AMIA case began in September 2004, and in November 2005, the prosecutor named a Lebanese militant from Hezbollah as the suicide bomber in the AMIA case.

In June 2006, the House approved H.Con.Res. 338 (Ros-Lehtinen), which "recognizes the potential threat that sympathizers and financiers of Islamist terrorist organizations that operate in the Western Hemisphere pose to the United States, our allies, and interests." The resolution also encourages the President to direct the U.S. representatives to the Organization of American States to seek support for the creation of a special task force to assist governments in investigating and combating the proliferation of Islamist terrorist organizations in the region.

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<sup>6</sup> "Washington Watch: Argentina," *LatinNews.com*, Sept. 20, 2006.